

R J R D I S T R I B U T O R

# UPDATE

VOLUME 2, NUMBER 1

NOVEMBER 1993



## TO OUR CUSTOMERS:

The events of the last three months have had a significant impact on all of us. Some might even say we have entered a period of instability that could result in a strained relationship with the profitability of both distributor and manufacturer has been significantly altered.

In the past, as problems arose, we worked out our differences and solved them, always mindful that neither the manufacturer, wholesaler, or retailer can isolate themselves from each other. Yet, all of the difficulties we have faced together seem pale in comparison to the sudden and unprecedented rollback of prices by a major manufacturer.

Immediately, we moved into uncharted waters as the significance of that decision is difficult to sink in. I am sure you have already calculated what the rollback will cost your business, as we have ours. Restoring profitability into the cigarette category will be a challenge to everyone. For most of us, it will mean finding more efficient ways to operate in an environment of continuing intense competition. It will mean stretching our resources as far as we can and taking unnecessary cost out of our business.

However, the outlook for our future should not be overshadowed by the pessimistic views of stock analysts or outside industry observers. I believe we are going to learn a great deal from this experience and make some long overdue changes to the way we conduct business.

On our part, we will concentrate more on the basic fundamentals of selling our goods through the distribution channels down to the consumer. We will carefully review all costs associated with doing business as usual while maintaining what is essential to growing your business and ours.

For you, our customer, we anticipate that you also will be examining how to more efficiently and effectively run your operations. The path to future profitability among distributors will be narrowed to those who become self-reliant and in control of their own destiny.

In the future, the ties between us must be drawn even tighter.

Sincerely,

Larry S. Schreiber  
Vice President, Trade Development

*RJReynolds*  
Estate of J. P. Reynolds

We Work For Smokers.

# UPDATE

RJR

## COMMENTARY

In 1990 we made a major commitment to our direct buying customers through the introduction of the Winners Program. We had just abandoned the practice of trade loading and adopted a strategy of inventory supply based on consumer consumption as the optimum "best practices" for the industry and R.J. Reynolds.

We knew that profit stability, for many of our customers was dependent on trade loading. The Winners Program was provided to transition into a no-load environment.

From its inception, the program has had broad trade acceptance and participation. We have continued to improve our customers earnings opportunities with yearly revisions by offering new ways to participate in "Winners."

This year the industry was rocked and financially impacted from "price wars". The impact of these events has had a dramatic effect on our Company and the entire industry. Every distributor and manufacturers' profits have been diminished, short and long term. Our earnings for 1993 will be reduced in excess of \$900 million.

Matching our competitor's price rollback simply means we will have less money to spend in 1994.

Consequently, we have had to make some difficult business decisions to stabilize our earnings and to position ourselves for long term restoration of profitability in the 90's.

We have already reduced the size of our company both internally and externally. Trade spending levels for both our wholesale and retail customers will be reduced to levels necessary to sustain our core marketing and sales efforts to our trade partners as well as our consumers. Consequently, this means we are not able to sustain the same level of financial support to our Winners Program in 1994.

Despite this situation, we want to make it clear that we are not abandoning our trade partners. Payments under the Winners Program will be honored through the fourth quarter in 1993.

There will be a Performance Incentive Program available to all direct buying customers in 1994. Your RJR sales representative will be contacting you shortly with the details. This program will have a reduced payment and is consistent with our current environment of cost reductions we have made throughout our company.

We will continue to evaluate this program throughout 1994, as well as any other opportunities that may arise.

R.J. Reynolds Tobacco Company appreciates your continued cooperation and understanding as we work through this difficult period. We remain committed to move forward to rebuild our mutual profitability.

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# UPDATE

## RJR'S ELECTRONIC HIGHWAY

It's Putting Business In The Fast Lane

As companies search for more efficient ways to do business in today's ever changing business environment, Electronic Technology should be considered a priority. R.J. Reynolds Tobacco Company (RJR) has supported and been active in Electronic Technology since 1986 with our Electronic Data Interchange (EDI) and Electronic Funds Transfer (EFT) programs. These programs have always provided a WIN/WIN environment for the participants.

Participation in EDI and EFT has increased steadily over the past seven years. Our electronic trading partners have seen the need (e.g., **benefit**) to transfer even more information electronically. We have responded by providing EDI enhancements such as price change and item maintenance information. RJR is committed to increasing the flow of business information electronically.

Even though steady progress has been attained during the past several years, there is still room for improvement. Many companies continue to view EDI as just another way to send business information, and development cost is a prohibitor. Granted, there are costs associated (i.e., software, modems and communication). However, positive benefits gained by integrating EDI into more applications can be realized. Integration into everyday business functions is where true benefits are derived.

What does the future hold? We believe advanced technology will continue to assert itself as one of the **major** building blocks of the successful companies of the future. However, there is much more - **Efficient Consumer Response (ECR)**. ECR is more than technology. ECR is a strategy that uses EDI to streamline the total product distribution system from the manufacturer to the consumer. Instead of the distribution system being driven from the supplier to the consumer, it will be consumer driven. As you may envision, concepts such as ECR would change the way we do business today. The ultimate application of ECR in our industry is yet to be determined.

RJR is constantly evaluating new technology and concepts such as ECR, and the role they will play in the way we do business in the future. We currently offer EDI and EFT technologies to our direct trading partners; encourage all our customers to evaluate their business processes; and as partners, prepare for the future.

### WANT INFORMATION FAST? .....GET IT THROUGH FAX

Our Customer Service Department is currently asking all direct buying customers to provide a FAX number for their bill-to and ship-to locations. These FAX numbers will be used to send company information normally sent by Western Union Mailgram. If you wish to receive information through FAX and have not made your request known to us, please call our Customer Service Department at 1-800-861-4338. Do it now.

And remember, if for any reason, we can't complete a FAX transmission to your locations, a mailgram will be sent instead. It's a foolproof method of ensuring that you receive information as soon as possible.

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# UPDATE



**Yancey W. Ford, Jr.**

*Executive Vice President - Sales  
R.J. Reynolds Tobacco Company*

## **Raising the Fed Cigarette Tax Would Be Disastrous**

As individuals who have chosen to make tobacco a part of our lives, whether as a distributor, a retailer, a manufacturer, a grower, an advertiser, or perhaps simply as a smoker, we have all been called upon at one time or another to defend tobacco.

Nothing in the past, however, measures up in importance to the immediate challenge now facing us.

Various proposals now being considered in Washington to increase the federal cigarette tax threaten hundreds of thousands of American jobs and businesses throughout the United States. Whether we end up with a doubling of the current 24¢-a-pack federal tax, or a 75¢ increase, the impact on all those who deal with tobacco would be catastrophic. And the fallout from such an event would touch every American citizen.

Tobacco provides 2.3 million Americans with jobs across all 50 states, directly and indirectly. Companies and employees involved with tobacco pay more than \$6.5 billion in payroll taxes to the federal government each year, and another billion-plus to the states. Cigarette excise taxes contribute another \$12 billion to state and federal treasuries.

Price Waterhouse, a major international accounting firm, recently completed an economic analysis of tobacco. Based on an analysis of that study, we know that a 75¢-a-pack increase in the excise tax would mean a loss of almost 5,570 wholesale trade jobs; some 20,015 retail jobs would be eliminated; another 6,063 tobacco manufacturing jobs would vanish, and almost 19,501 farming jobs would be gone.

Thousands of businesses - from paper companies to computer makers to advertisers - supply the tobacco industry. With a 75¢-a-pack excise tax increase, more than 81,762 jobs would evaporate from this tobacco-supplier sector of the U.S. economy. With the loss of all these workers and their paychecks that buy food, clothing and everything else families require, the destructive ripple of tobacco unemployment would reach far and wide and add another 192,140 more Americans to unemployment.

The total economic damage in terms of unemployment with a 75¢-a-pack increase: 273,902 jobs and \$8.0 billion in payroll - gone.

Even a "simple" doubling of the federal cigarette tax - to 48¢-a-pack - would be a serious blow to the U.S. economy. Almost 115,000 workers would face unemployment and \$3.3 billion would be lost in paychecks.

But that's not all. These ill-conceived proposals being considered in Washington, D.C. would touch Americans in other ways. Cigarette taxes traditionally have been a source for generating revenues at the state level. The revenues collected from every pack of cigarettes sold in each state helps pay for important services, including education. But if the federal government in Washington decides to raise the federal tax, then the states will lose state excise tax revenue when cigarette sales drop.

Based on the Price Waterhouse data, the states stand to lose \$800 million in state excise taxes with a 75¢-a-pack increase. That's \$800 million that's either got to be made up through new state taxes, or through reductions in state services. What will be cut? Education? Support for the elderly?

### **Other Arguments**

The economic arguments - the clear cut facts on how these tax proposals would harm the American economy - are most compelling. But there are other reasons why a federal cigarette tax increase is a bad idea.

**Cigarette taxes unfairly hit those least able to afford it:** the low and middle-income taxpayers.

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No matter how high or low a person's income, they pay the same amount of cigarette taxes. A 1987 study by the Congressional Budget Office found that for someone making less than \$5,000 a year, federal excise taxes take 4.9 percent of their income. For a person making \$50,000 a year, they pay only 0.6 percent. Most people's idea of a fair tax is one that rises with the taxpayer's income. On the test of fairness, cigarette taxes fail miserably.

**Cigarette taxes are high enough already.** Besides the \$6 billion in federal taxes, smokers also pay another \$6 billion in state and local cigarette taxes. For a pack-and-a-half-a-day smoker, this translates, on average, to nearly \$300 a year.

**The government will not get the money it expects by raising taxes.** In 1990, the federal government raised alcohol tax from \$12 to \$13.40 a gallon – and lost \$87 million. Why? Because when consumer goods are taxed, people can avoid the taxes by not buying the goods. Consider Canada. Following a huge cigarette tax increase in late 1991, initial estimates had the Canadian government losing \$800 million a year (final figures are not yet available). Canadians crossed the border to buy their brands in U.S. stores. Smuggling and black markets are thriving.

**Smokers already pay their fair share.** According to an article in *The Journal of the American Medical Association* (March 17, 1989), "...On balance, smokers probably pay their way with the current level of excise taxes on cigarettes." And that statement was made before two federal excise tax increases and scores of increases at the state level.

**If America's health-care system is broken, the government should fix it – not just throw more money at the problem.** According to *Consumer Reports*, Americans spent \$817 billion on health care in 1992. But at least \$200 billion was thrown away on overpriced, useless treatments and on a bloated bureaucracy. Former U.S. Secretary of Health, Education and Welfare Joseph Califano sums up the situation succinctly. He has said the amount of "fraud and abuse is enough to provide all the health-care coverage all Americans need. We wouldn't have any gaps in our health-care system if we could apply that to health-care coverage for Americans."

**A major tax increase will not deter youth from smoking.** Proponents of a major increase say keeping kids from smoking through higher taxes is reason enough to raise the tax. But where this has been tried, the tax didn't do what its supporters said it was supposed to do. Last year in California, health authorities got together to review the results of a major tax increase enacted three years earlier. A 250 percent state excise tax increase had been approved by voters in 1988, many of whom thought it would be a way to keep kids from smoking. To the dismay of conference participants, a spokesman for the California program reported that the tax appeared "to have had little effect" on adolescents, and that their rate of smoking was virtually unchanged.

Youth smoking can and must be reduced – but raising taxes is not the answer. At R.J. Reynolds, we have a number of programs underway to reach kids, parents and, importantly, retailers in our communities. While our programs are not the only answer, we think we can help – and we're not alone. Since January, actor Danny Glover, one of Hollywood's most respected performers and who is known for his work with kids, has been speaking to students and teachers around the country about not smoking, and he's been visiting with retailers as part of our "Support The Law – It Works" retailer program.

## Do Americans Really Favor This Tax?

Given all the reasons why a major tobacco excise is a bad idea, a surprisingly large percentage of Americans seem to favor such a tax. Or is it so surprising? Three-fourths of American adults do not smoke – and proponents of the tax have been doing nothing to discourage the public to assume that, if they don't smoke, there will be no economic price to pay for this tax.

We know better. We know that these tobacco tax proposals, if allowed to be enacted, would cost America hundreds of thousands of jobs, take billions of dollars out of the economy, and significantly reduce revenue for the states.

Our task is clear. Each of us must educate the American public about the real impact of these tax proposals. We need to spread the word among our friends, families and neighbors. And then write our elected officials and tell them we oppose any increase in the excise tax on tobacco. If you don't know who your representatives are, call 1-800-STOPFET (1-800-786-7338) to find out.

Never have we faced such a critical issue. I urge everyone to get active and stay involved.

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# UPDATE

## Winston Summer Promotion

A Success  
*Thanks to you!*

In this ever changing industry, competition, rather than internally generated long range plans often dictates the course of events that impact the cigarette business.

Such was the case in April of this year when we made the decision to respond swiftly to a competitive announcement of a national buydown program on one of the industries biggest brands. As you are aware, this led to a national promotion on WINSTON, targeting adult smokers with promotionally packaged WINSTON product discounted by \$4.00 per carton or 40¢ per pack. This response required a lot of new thinking for us as well as our direct buying customers.

It was not an easy concept to implement. First, there was the logistics of separating promotional SKUs and UPC codes and the administration involved in the process. On hand WINSTON inventory had to be held while promoted product was moved through retail. Potential availability issues related to allocation of promoted product had to be resolved.

From the outset we wanted our direct customers to share in the financial benefits of the promotion. We reduced your list price by \$4.14 which was more than the straight \$4.00 list price reduction and included a \$6.00 case allowance to offset administration costs. We provided additional compensation for holding non-promoted product.

The WINSTON Summer Promotion proved to be an excellent plan in concept and execution, based on favorable reports from all trade segments. It was developed within the shortest lead time of any program in our recent history. But even the best of plans cannot succeed without the cooperation of our direct customers. Much of the success of our WINSTON Summer Promotion is credited to you.

After the price rollback on August 9, when it became necessary to return remaining inventories of the promoted WINSTON product, once again you lent your support to help make the operation run smoothly.

Yes, we are proud of the implementation of the WINSTON Summer Promotion. And we do not hesitate to acknowledge how important your role was on its successful outcome.

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## RJR'S OPINION SURVEY

**Question:** How should RJR approach this issue in 1994?

Question: What steps do you plan to take concerning this issue in 1994?

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